

IPART's Maximum prices to connect, extend or upgrade a service for metropolitan water agencies – Draft report and draft determination

Sydney Water's response – 6 August 2018



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1 Executive summary

Sydney Water welcomes the opportunity to respond to the Independent Pricing and Regulatory Tribunal's (IPART's) *Maximum prices to connect, extend or upgrade a service for metropolitan water agencies – Draft Report* (the Draft Report) and associated Draft Determination (the Draft Determination).

Connection charges help fund the cost of infrastructure needed to support population and employment growth and/or improved service levels. These charges can improve economic efficiency by ensuring infrastructure costs are considered in decisions about the location and scale of growth areas and/or the method used to increase service levels. Sydney Water supports funding frameworks that include connection charges as they have potential to promote a fairer outcome for the community. They do this by ensuring the main beneficiaries of new infrastructure bear some (or all) of the cost and risk of building that infrastructure.

Developer Charges – Further reform needed to support the sustainable growth of our cities

Although water, wastewater and stormwater developer charges remain set to zero by the NSW Government (for Sydney and Hunter only), we support the review of these charges for all metropolitan water agencies to bring the methodology up-to-date in the event they are reintroduced. IPART has proposed some key improvements including to:

- preclude negative developer charges – all development benefits from being able to connect to our services so this should be reflected in the charges
- allow voluntary agreements with developers - this presents a great opportunity for utilities to work collaboratively with developers on win-win funding arrangements to deliver enhanced services and infrastructure which customers value
- allow an 18-month transition period should developer charges be re-introduced – we appreciate IPART's recognition of the time needed to prepare new and/or update Development Servicing Plans (DSPs).

Sydney Water proposed a far broader package of reforms than those proposed in IPART's Draft Report. Although IPART acknowledged some of the advantages of our proposals, they have preferred to use a single approach that all agencies are able to currently implement. Sydney Water believes the wider reforms we proposed would have:

- improved the equity between the charges paid by new and existing customers
- provided a sound base for fairer competition going forward.

As such, we believe IPART's decisions in their Draft Report and Draft Determination mean the charges, if re-introduced, may not adequately support the sustainable growth our cities need.

New voluntary charge for firefighting upgrades – framework remains missing

IPART has proposed a new charge that would allow property owners to band together to fund an upgrade to a water main serving their properties to ensure compliance with modern firefighting

standards imposed under the Building Code of Australia (BCA). These service upgrades have the potential to enable cost-effective provision of water flow and pressure for firefighting if needed for compliance reasons. This will allow more cost-effective solutions in cases where on-site remedies prove more costly or impractical. We strongly support this aim and have been working collaboratively with Fire and Rescue NSW (FRNSW) and local Councils to address this issue over the last few years.

However, as IPART has previously highlighted, there unfortunately remain some regulatory gaps on water flow and pressure for firefighting in NSW. This will result in some practical challenges in implementing the determination. For example, orders on properties to address firefighting requirements currently occur on an ad hoc basis, rather than for an entire area at once. In the absence of an active fire order from Council, the incentive for property owners to make a monetary contribution to a voluntary upgrade would seem very low. To be effective, there is a need for an agreed framework to facilitate the application of IPART's new pricing approach. Sydney Water is happy to continue to be involved in discussions around this issue.

Priority Sewerage Program (PSP) – significant shift to using a harmonised pricing method

In the past, IPART has applied different methods for calculating very similar charges – for example, backlog sewer connections were largely funded by the bills paid by the existing customer base (postage stamp prices) whereas Minor Service Extensions (MSEs) were paid for by the connecting properties only. IPART has taken the opportunity to consolidate the different approaches and use the same approach as the developer charge method. We support IPART's intention to apply a consistent method to calculate the charges for any new property who wishes to connect so long as the costs are shared in an equitable, transparent and administratively efficient manner.

We agree with IPART that costs should be shared between the connecting customers and the broader customer base depending on the externalities arising from these connections. IPART's commitment to assess these departures from the standard charges on a case-by-case basis is a welcome improvement. However, we note that this may not provide the certainty that PSP customers, in particular, are looking for. IPART's proposal is a significant change to the existing price regime for PSP properties as it shifts the cost burden to connecting customers in the first instance. This differs significantly from the historical approach.

At present, the cost to PSP customers is limited to that of modifying their private plumbing. All other costs have been funded by a combination of Community Service Obligation (CSO) payments from the NSW Treasury and postage stamp prices. The draft determination represents a big change for the remaining PSP areas, including those listed in Sydney Water's current Operating Licence. If customers do not agree to pay the (potentially very high) PSP charges from the updated methodology, Sydney Water may be unable to deliver any further PSP schemes unless alternative funding mechanisms are found.

Our current Operating Licence requires Sydney Water to cooperate and participate in a Government review of the PSP and if required by the Minister, comply with any outcomes. While this has not occurred to date, we would be happy to participate in any such review.

Minor Service Extensions – improvement needed for process and for planning costs

IPART has proposed a relatively small change to the MSE charges methodology while developer charges are set to zero. That is, these properties will no longer get credit for the future periodic charges they would have paid after connecting. This will see MSE charges increase by around \$6,000 and \$7,500 for a new water and wastewater connection respectively for a residential MSE property.

While revenue from periodic charges will be taken into account in estimating the MSE charge if developer charges are re-introduced, this will be offset by a requirement for MSE properties to make a contribution towards the cost of any existing assets used by their property (for example, downstream trunk mains, pumping stations and treatment plants). Depending on the context, this contribution could be quite significant.

Sydney Water supports IPART's decision to allow property owners to pay in annual instalments over up to 20 years as this may provide some relief to what might otherwise be a significant burden. However, we note that even with such arrangements in place, customer participation in MSE schemes has historically been low.

Currently, Sydney Water only conducts planning of MSE cases after we receive payment of the MSE application fee set by IPART. In practice, we have found that this fee is far below the actual cost of conducting such planning. The current fee is set to the same level as an application for a Section 73 Compliance Certificate. However, the section 73 process is fundamentally different to the process for a minor service extension request:

- For section 73 applications, Sydney Water considers the location of the property, the likely demand on our networks, and provides advice on the availability of points of connection to those networks. Based on this information, the applicant is responsible for the design and construction of new assets. For larger developments, the applicant may also need to develop a servicing strategy (if one currently doesn't exist).
- For minor service extension applications, Sydney Water performs additional functions such as project design, since construction is typically undertaken by Sydney Water. The different emphasis in the MSE process is reflected in the new procedural requirements outlined in the draft determination, which includes a need to prepare a formal DSP for larger schemes.

Preparation of servicing strategies and detailed designs for an MSE application, and documenting the outcomes in a DSP for larger schemes, will involve significant costs well above the MSE application fee. These costs can't be recovered if the applicants do not wish to proceed, which has often been the case in the past. We recommend IPART consider including all MSE related charging in their Final Determination. If this occurs, our preference would be for a two-step application process. That is, the initial application fee could be set to cover an indicative quote or likely order of cost estimate. If a property owner or owners felt that this quotation represented good value, they could then proceed to paying a full application fee which could more closely align with

the actual cost to prepare such a quote. We would be happy to provide IPART with more detailed information to help them determine such charges¹.

Other administrative issues for MSEs and PSPs

IPART has proposed that utilities will need to prepare and exhibit a Development Servicing Plan (DSP) for any MSE or PSP scheme that is at the scale of a whole town, village or suburb. This will extend the time required to process applications, for minimal benefit. We do not believe that the requirement to produce such small-scale DSPs is in line with IPART's decision to allow utilities to determine the boundaries for any DSP they produce.

Across greater Sydney, there are many thousands of properties that may want to consider a MSE application. From an administrative perspective, it is unclear whether:

- A DSP for larger-scale schemes need only be prepared once an application is received;
- A DSP can or should cover multiple locations that are the subject of an MSE application (either real or potential), particularly if they all use common assets.

IPART has proposed to grandfather existing prices that have been set under past determinations for payments under *pre-existing annuity arrangements* only. We believe this may be an oversight as this would exclude many current MSE cases and PSP schemes. For example, MSE applications that have not been finalised and existing MSE cases where a quote has been provided but a customer has not yet connected would appear to be excluded from the proposed grandfathering arrangement. We do not believe it fair that prices for MSEs should be subject to significant change once a customer has paid the application fee.

The PSP was established by the NSW Government in 1997, with a second stage announced in 1999. When planning for the delivery of services, Sydney Water considers the availability of infrastructure in adjacent areas. To deliver schemes at the lowest lifecycle cost, and depending on the expected timing of development in the wider region, there can be benefits in deferring the delivery of services. This has been the case in locations such as Austral, Menangle and Menangle Park, where early planning work identified the likelihood of large scale urban development nearby. For these areas, residents have been informed that services will be provided once there is sufficient evidence of growth in surrounding land, a position that Sydney Water has held consistently since 2006.

Unfortunately, and for reasons beyond Sydney Water's control, there have been significant delays in the rezoning of adjacent land. In the case of Menangle, for example, land for urban development was released in 2001 but rezoning was only finalized in 2017. As a result, properties that formed part of the original PSP remain unserved. In Austral and Menangle Park, surrounding development is beginning to encroach on the area, and they are likely to be serviced as part of the normal delivery of trunk services through Sydney Water capital expenditure. If applied to these areas, the draft determination could significantly alter the funding contribution required by residents and may undermine the financial viability of the schemes. At the same time, however, the increase in the

¹ Our recommendation for a two-tiered application fee approach also applies to existing service upgrades (ESU), as outlined in Section 5.4

surrounding population could potentially increase risks to public health and the environment if the PSP areas remained unserved. These issues should be carefully considered by IPART in finalising this review.

[Sydney Water Developer Direct – deferring decision until 2020](#)

We believe that price regulation is unnecessary for our Developer Direct product and may in fact result in a worse outcome for customers. IPART has deferred further consideration of Developer Direct until the 2020 retail price review. In the meantime, we will continue to apply the existing unregulated charges.

2 Introduction

Connection charges are paid to a water utility to cover the costs of providing or upgrading water, wastewater and/or stormwater infrastructure. For new development, these are paid by developers and for existing properties, these are paid by the property owner.

Sydney Water welcomes the opportunity to respond to IPART's Draft Report and Draft Determination for these charges. Although Sydney Water's water, wastewater and stormwater developer charges² (new connection charges for new developments) remain set to zero by the NSW Government, this determination is important for all NSW metropolitan water agencies as it aims to:

- update the methodology in the event these connection charges for new development are reintroduced (for Sydney and/or Hunter Water)
- bring all other connection charges under one consistent determination, including:
 - Minor Service Extension (MSE) charges - the charges we currently charge for when existing properties want us to extend our network to provide a point of connection for their property
 - Backlog sewerage charges - for example, for Priority Sewerage Program (PSP) areas
 - Voluntary existing service upgrade (ESU) charges - a new charge which may help some customers comply with increased fire-fighting capacity requirements more cost effectively.

In our previous response to IPART's review of these charges³ we discussed the broader context for IPART's review and the outcomes any future developer charges framework should support in detail. As our positions have not changed since that response, in this chapter we reiterate a summary of our position and refer readers to see more detailed discussion provided in our December response. This chapter also includes a summary of our response to the draft decisions set out in the Draft Report and Draft Determination.

2.1 Sydney Water's position on connection charges

The urban areas we serve are facing unprecedented population and employment growth. IPART's review of connection charges is an opportunity to examine the composition and role these charges play to maximise their potential to support affordable and timely infrastructure. As the NSW

² For the first time in this draft, IPART adopted a new umbrella term, *connection charges* for what were previously referred to as *developer and other related charges*. As such, in our response we will generally use the new umbrella term, along with categorisation according to the type of property it applies to: new or existing, and whether the charge is for a new connection or an upgrade to an existing connection.

³ [IPART review of developer charges and backlog sewerage charges for metropolitan water agencies 2017 Sydney Water response to IPART's Issues Paper, December 2017](#)

Government set Sydney Water's and Hunter Water's new connection charges⁴ for water, wastewater and stormwater to zero in 2008, changes to the methodology could also be considered and/or introduced without them causing disruption to long-standing practices.

New connection charges have recently been highlighted by a number of agencies as needing review. The Productivity Commission identified the charges as needing review to better support integrated water cycle management (IWCM) approaches⁵. The Greater Sydney Commission's Draft Regional Plan – *Our Greater Sydney 2056, a metropolis of three cities – connecting people* (GSC Draft Regional Plan) articulates the need to:

carefully balance requirements to fund infrastructure without burdening private development unreasonably, by better understanding the cumulative impacts of developer contributions in different markets across Greater Sydney

Sydney Water supports the objectives identified by both these bodies and looks forward to working with IPART and other stakeholders to ensure housing affordability is prioritised.

2.2 Structure of this report

Our response includes our views on IPART's decisions and briefly reiterates the other potential improvements to the current regulation of and methodology we proposed in our previous December response.

Our response is structured as follows:

- Chapter 2 outlines the context of this review and summarises our views on IPART's proposed decisions in the Draft Report and Draft Determination
- Chapter 3 discusses the proposed changes to the current developer charges methodology and parameters and reiterates our views on how the methodology could be further improved
- Chapter 4 outlines our support for the proposed amendments to the current Developer Servicing Plan (DSP) procedural requirements
- Chapter 5 contains our views on the two other related charges in our area of operations; backlog sewerage and minor service extensions
- Chapter 6 outlines our views on the proposal to set a methodology for a new charge for upgrading existing services to existing properties to improve firefighting capability.

The following section contains a summary of each of our responses to IPART's questions. These are also discussed in more detail in the Chapters.

⁴ Previously known as developer charges.

⁵ [2017, Productivity Commission, National Water Reform, Report no. 87, Canberra](#), Recommendation 6.2d

2.3 Summary of IPART's draft decisions and Sydney Water's responses

In this section we provide a summary of our response to each of IPART's draft decisions and to their recommendation.

Methodology to set prices for new connections to new developments

Decision 1 *Maintain the key features of the 2000 methodology, which calculates capital charges, minus the reduction amount, per equivalent tenement (ET), on a net present value (NPV) basis.*

Accept. IPART's methodology is theoretically sound and has potential to provide location based cost signals to foster more efficient growth.

Capital charges

Decision 2 *Maintain our current approach of calculating capital charge components separately for pre-1996 and post-1996 assets.*

Disagree. If IPART allowed use of RAB valuation and inclusion of all assets with a nexus to development, this arbitrary distinction would not be necessary. Sydney Water's proposed approach would also ensure end-use customers and developers both paid an equal allocation and fair share of the costs of investment. Sydney Water proposed a cost allocation method that would remove the need to make arbitrary distinctions such as pre-1970 assets or 'DSP date minus 30 years' assets. This also eliminates the need for more than one discount rate.

Decision 3a *Maintain our current approach to:*

– *exclude pre-1970 assets from the capital charge calculation*

Disagree. All assets with a nexus to development should be included in the charge calculation. Sydney Water proposed a cost allocation method that would remove the need to make arbitrary distinctions such as pre-1970 assets or 'DSP date minus 30 years' assets.

Decision 3b *Maintain our current approach to:*

– *not limit the period of inclusion of assets yet to be commissioned,*

Agree. All assets with a nexus to development should be included in the charge calculation.

Decision 3c *Maintain our current approach to:*

– *the criteria for exceptions to asset inclusion.*

Partially agree. We do not agree with the decision to arbitrarily exclude assets commissioned before January 1970, even though they would have been sized for the growth that is now occurring. This decision will lead to inequitable cost sharing between existing customers and new connection charges. We agree with the other exclusions.

Decision 4 *Maintain our current approach to including headworks assets regardless of their ownership or funding arrangements.*

Although we agree with this approach in principle, we are concerned that the administrative costs to include WaterNSW water headworks charges may be higher than the potential benefits considering that headworks charges are likely to be the same across all water systems.

Decision 5 *Exclude the Sydney Desalination Plant's assets from headworks assets for Sydney Water.*

Agree. This is sensible considering the primary role of the Sydney Desalination Plant is drought response.

Decision 6 *Maintain our current approach to apportion shared assets between DSP areas using expected utilisation based on ETs.*

Accept. This is sensible and practical given residential properties remain the most common property type and this method has been a long-standing practice in the water industry.

Decision 7 *Maintain our current approach to valuing assets already commissioned on a Modern Engineering Equivalent Replacement Asset (MEERA) basis, and assets yet to be commissioned on an estimated efficient costs basis.*

Disagree. Disaggregated RAB values should be used for existing assets, if available, to ensure consistency with periodic charges, and that developers do not pay more than their fair share of costs to service their development. Where disaggregated RAB values are not available, depreciated optimised replacement cost (DORC) should be used.

The 'reduction amount'

Decision 8 *Maintain our current approach to the reduction amount component of developer charges, which relates to postage stamp revenues and location-specific operating costs, for a period of 30 years.*

Agree. It is important that both incremental operating costs and revenues continue to be included in the charge calculation to ensure the charges reflect the true location-specific net cost impact of development. The 30-year forecasting period is also preferable as this aligns with Sydney Water's 30-year growth planning horizon.

Discount rates

Decision 9 *Maintain the current differential application of discount rates to pre-1996 and post-1996 assets.*

Disagree. IPART should allow use of the pre-tax real WACC for the periodic price determination to utilities who have an approved Cost Allocation Manual (CAM). This would allow for charges to be set such that end-use customers and developers both pay an equal allocation and fair share of the costs of investment.

Decision 10 *Maintain the discount rates for pre-1996 assets at:*

- the real pre-tax rate of 3% for Sydney Water and Hunter Water, and
- the real pre-tax rate of 0% for the Central Coast Council.

Disagree. To ensure consistency between periodic charges and developer charges, and that end-use customers and developers both pay an equal allocation and fair share of the costs of investment, IPART should apply the same discount rate as the benchmark WACC determined for the periodic price determination. This should be the pre-tax real WACC, as developer charges are calculated on a pre-tax basis.

Decision 11 *Update the discount rates for post-1996 assets and for the reduction amount to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination.*

Agree. We note that the utility's pre-tax WACC is appropriate discount rate for all components of the charge.

Decision 12 *Not to apply a WACC adjustment once the developer charges are calculated.*

Agree. The five-year review is sufficiently frequent to keep discount rates up to date. Additional adjustments would add administrative burden for little benefit.

Equivalent tenements (ETs)

Decision 13 *Maintain the annual consumption of an average residential dwelling as our measure of an equivalent tenement (ET).*

Agree. In order to improve clarity for developers, it would be preferable for IPART to provide further guidance as to how ETs relate to non-residential and multi-unit residential property types. Our preference is for ETs to be defined according to the demand placed on infrastructure by each property type relative to an average single residential property.

Decision 14 *Update the ET value with the consumption for an average residential dwelling referred to in the Final Report accompanying the prevailing periodic price determination.*

Agree. The periodic price review is the appropriate reference for this measure to ensure consistency between customer bills and new and/or upgraded connection charges.

Prices cannot be negative

Decision 15 *Amend the methodology so that if the calculated price is negative, it is set to zero.*

Strongly agree. All development benefits from being able to connect to our services so this should be reflected in the charges.

Voluntary opt-outs are permitted

Decision 16 *Allow utilities and developers to opt-out of the determination through bilateral agreements, subject to ring-fencing of unregulated costs.*

Strongly agree. This presents a great opportunity for utilities to work collaboratively with developers on win-win funding arrangements to deliver enhanced services and infrastructure which customers value.

Procedural requirements around development servicing plans (DSPs)

Decision 17 *Maintain the current DSP content requirement, with minor amendments.*

Agree. The proposed minor changes are sensible improvements and will not significantly add to the administrative burden.

Decision 18 *Maintain the current requirement to exhibit, advertise and consult on DSPs, with minor amendments.*

Agree. The proposed DSP consultation requirements and dispute resolution process are largely sound. We suggest minor improvements to aid clarity and streamline consultation.

Decision 19 *Require a DSP review once every five years, however, this requirement can be shortened, extended or waived, as approved or directed by IPART.*

Agree. This will give utilities flexibility to respond to changing circumstances, such as revised population forecasts or variances in the timing or nature of changes to land use zoning.

Decision 20 *Suspend the DSP review requirement while the NSW Treasurer's direction on zero developer charges is in place.*

Strongly agree. This is a practical measure which will save unnecessary administrative costs.

Decision 21 *Provide for a transition period of up to 18 months to apply in the event that the Government's nil developer charges policy is removed, and set maximum prices to zero until the end of that period, or until the relevant utility complies with the relevant procedural requirements set out in the determination, whichever occurs earliest.*

Accept. Our preference is for the determination to be reviewed at that time, that is, before any re-introduction of the charges. This would allow for further improvements to be made which would better support the sustainable growth our cities need, as well as taking into account any other policy changes the Government may have made as part of a decision to re-introduce developer charges.

Decision 22 *Maintain our current role in approving the calculation spreadsheet and registering the DSP.*

Agree. Further scrutiny of charges is best placed with the developers who pay them. The exhibition period is the appropriate vehicle for such feedback so changes can be incorporated into the charges if necessary, before they are registered.

Decision 23 *Release a template spreadsheet that utilities can use, on a voluntary basis, to calculate developer charges.*

Agree. Sydney Water notes that some of the terminology and details in the draft spreadsheet template prepared by IPART do not appear to be consistent with the draft determination. Sydney Water recommends that both the spreadsheet and the determination be reviewed for consistency before being finalised.

Decision 24 *Maintain our current approach of not prescribing how the DSP areas are set.*

Strongly agree. Utilities are best placed to balance any trade-off between adopting smaller DSP areas for increased cost-reflectivity and larger areas to reduce both volatility in the charges and administrative costs

Price indexation factor

Decision 25 *Update the CPI indexation factor for annual adjustments to prices between DSP reviews, to March-on-March quarter CPI, ABS all groups eight capital cities.*

Agree. Consistency of CPI indexation between our determinations is beneficial and sensible in that it may avoid any potential confusion and/or possibility of error from incorrectly applying a CPI index from a different determination.

Methodology to set prices for new connections to existing properties

Decision 26 *Apply a uniform methodology to set maximum prices for a new service connection to an existing property.*

Agree. Although IPART's net present value (NPV) methodology could be improved, it is preferable that a single method be used for all properties

Decision 27 *Grandfather existing backlog sewerage and minor service extension charges calculated and applied on an annuity basis under our:*

- 1997 and 2006 Determinations of backlog sewerage charges, and
- 2016 Determination of retail prices for Sydney Water.

Accept. However, Sydney Water considers there is also a good case to also grandfather Any existing MSE projects where Sydney Water has received a valid application but the scheme has not yet moved to construction and/or the customer has not yet connected.

Decision 28 *Maintain the annuity payment option for providing a new service to existing properties. This annuity is based on:*

- the discount rate set to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination, and
- the annuity period of up to 20 years.

We support this decision. A deferred payment arrangement is likely to assist customers that may be willing to connect but do not have sufficient funds available to make a single, potentially large, up-front payment.

Decision 29 *Calculate prices when the service becomes available. The CPI indexation factor applies to prices for connection at a later date (March-on-March quarter CPI, ABS all groups eight capital cities).*

Agree. This ensures equity between properties who connect earlier and later.

Decision 30 *Not to apply any WACC adjustment once the charge is calculated.*

Agree. As there are so few of these cases, additional adjustments would add administrative burden for little benefit.

Decision 31 *Make procedural requirements proportionate to the size of the scheme:*

– *Large-scale (township level) service extension schemes require making or reviewing a DSP, following the standard procedural requirements.*

– *Small scale extension schemes do not attract any specific procedural requirements and are subject to an ex-post review.*

Accept but note further improvement preferable. Sydney Water welcomes the ability to tailor procedural requirements to the size of the scheme. However, we note that the application fee for minor service extension applications is currently set at the same level as an application for a Section 73 compliance certificate. The application fee would be insufficient to recover the cost of preparing a servicing plan and DSP, and it is unclear how those costs might be recovered if customers decide not to proceed with the application.

In addition, it is not clear, for example, whether a DSP is intended to cover both actual and potential MSE applications within a DSP boundary if non-zero developer charges are in effect, particularly if they would all use common assets.

Methodology to set prices for service upgrade to existing properties

Decision 32 *Set the price for upgrading an existing service to existing properties, on a marginal cost basis.*

Agree. These charges should only relate to increasing the capacity of water assets for firefighting, and not to the costs of existing assets, because the owners already pay for existing assets through their periodic prices.

Decision 33 *Provide the annuity payment option for a voluntary upgrade of existing services to existing properties. This annuity is based on:*

– *The discount rate set to the utility's real pre-tax WACC referred to in the Final Report accompanying the prevailing periodic price determination.*

– *The annuity period of up to 20 years.*

Strongly agree. A deferred payment arrangement is likely to assist customers that may be willing to fund the upgrade but do not have sufficient funds available to make a single, potentially large, up-front payment.

Decision 34 *Calculate prices when the upgraded service becomes available. The CPI indexation factor applies to prices for connection at a later date (March-on-March quarter CPI, ABS all groups eight capital cities).*

Agree. This would ensure equity between those who agree to pay earlier and those who chose to pay later.

Decision 35 *Not to apply any WACC adjustment once the charge is calculated.*

Agree. Currently, adjustment would add unnecessary administrative burden, however, this may need to be reconsidered if these upgrades become common practice.

Decision 36 *Not to impose any procedural requirements for upgrading services for firefighting, subject to an ex-post review.*

Agree. Currently, procedural requirements would be premature and add unnecessary administrative burden, however, this may need to be reconsidered if these upgrades become common practice.

Sydney Water's Developer Direct

Decision 37 *Defer regulating SWDD's construction services until the 2020 Sydney Water price review.*

As discussed in our submission to the Issues Paper, we disagree with the need for regulation, as the relevant services provided by Developer Direct are clearly contestable. We would like the opportunity to better understand the reasons why IPART disagrees with our position and considers that regulation is necessary.

Draft recommendation for stakeholder comment

Recommendation 1 *We recommend the NSW Government's social policy objectives and Community Service Obligations be provided through a contestable process.*

This is a matter for the NSW Government. In principle, a competitive process for the delivery of services (or servicing solutions) could result in better outcomes or lower costs for customers.

3 New connections to new developments – developer charges methodology

IPART's draft decision is to maintain the current developer charges methodology, as they believe it remains theoretically sound. Sydney Water proposed improvements to this methodology which we believe would have:

- reduced administrative effort
- resulted in more equitable outcomes across different customer groups
- provided better support for housing affordability
- better supported Integrated Water Cycle Management approaches and liveability.

IPART has noted the advantages of many of our proposed changes, but decided not to include these considering that other utilities may not have the capability to apply alternative methods at the current time. However, we understand that IPART is working with other utilities on some of these approaches, such as component costing. As such, we believe the capability of all utilities will improve over time, and the current methodology should be again reviewed before any future re-introduction of the charges.

3.1 Summary of our position on the draft decisions on methodology

Sydney Water's position in relation to the key elements of IPART's proposed methodology and approach are:

- recommend the methodology and approach be reviewed before any re-introduction of non-zero developer charges
- accept the current net present value (NPV) methodology, which includes the capital cost components and the reduction amount, and is based on ETs. However, we note this is likely to be more costly to implement than less complex methods or the alternative method we proposed which allows consistent application of cost allocation for all purposes
- agree that, if the current methodology is to be retained, it is appropriate to update the parameters of the methodology such as discount rates and water demand assumptions
- oppose the use of the current approach to the capital cost component as this is based on an arbitrary classification and excludes the capital cost of pre-1970 assets which have a clear nexus to development
- accept the use of the current approach to the reduction amount
- agree with maintaining average consumption as the measure of an ET, and
- strongly support amending the current approach to ensure that developer charges cannot be negative as all development should bear some of the cost of the infrastructure it relies on.

3.2 IPART's methodology, its strengths and limitations

One of the key considerations for this review should be how it might best support the community's expectations of housing affordability and liveability. IPART's current methodology resulted in developers being able to connect to our infrastructure for free in a substantial portion of our area of operations, even though assets would have been designed and built with growth in mind. We do not believe the method reflects the true value developers gain from the availability of services to their developments.

One of the primary limitations of IPART's methodology is the assumption that the capacity available in major trunk assets constructed prior to 1970 should be provided for free to new connections. WSAA highlighted this limitation in its response to IPART's issues paper:

If a sheep pen holds 100 sheep we wouldn't say the 95th to 100th sheep were responsible for using up the capacity in the pen. All sheep fill the pen. Having zero developer charges is analogous to arguing some new entrants impose no costs on the system, where there is clearly a nexus between the services they receive and the costs of infrastructure.

IPART argued that the cost of some of these assets may have already been fully recovered through water prices. However, many assets have an economic life of 100 years, and assets constructed today under Sydney Water's growth program are recovered over a similar timeframe in postage stamp prices. In practice, it seems unlikely that all assets built prior to 1970 have been fully recovered. Sydney Water agrees we should not be paid twice for providing infrastructure but this is not what we proposed. Rather, we argued that the reason why some infrastructure has capacity to service growth, yet, may have already been fully paid for is that no forecast of growth, demand and cost recovery is ever completely accurate.

Existing customers bear the risk, and increased bills, when a forecast leads to under recovery of the cost to service growth. It would therefore be equitable to allow these same customers to benefit when an asset remains capable of servicing growth when, due to similar limitations of a forecast, its value has already been fully recovered. Rather than Sydney Water recovering the cost twice, the additional charges would result in lower ongoing customer bills. Non-zero charges would also ensure development receives the correct signal of the value that the availability of water and wastewater services provides to their development.

The other key limitation of IPART's methodology is that it is inconsistent with the assumptions used to calculate customer bills. Sydney Water proposed an alternative method for analysing historical costs. Our draft cost allocation methodology which we propose to use to determine to access prices for our declared wastewater systems allows the estimation of notional RAB values for all existing assets. A non-zero RAB value would imply that all costs have not yet been recovered. These estimated RAB values are consistent with the method used to calculate the ongoing charges paid by existing customers. As such, we believe it is sub-optimal to require Sydney Water to implement a different method for the calculation of developer charges. IPART's draft decision to only allow one method for the calculation of developer charges results in a significant disincentive for utilities to progress their cost allocation capability.

3.3 The capital cost component decisions are sub-optimal/inequitable

Sydney Water believes that there is room for significant improvement with the capital cost component of the developer charge calculation. Our position on this issue has not changed since we submitted our response to IPART's issues paper in December, 2017. As such, we re-iterate a summary of our position below:

- enforcing use of a single prescriptive methodology for asset valuation and cost allocation for all utilities presents a disincentive to innovate and improve. IPART could allow different treatments to encourage utilities who currently lack capability, to develop that capability
- the proposed pre-1996 and post-1996 assets distinction is sub optimal and would be unnecessary if IPART allowed consistent asset valuation and cost allocation for all purposes (retail prices, third-party access and developer charges)
- the excluding pre-1970 assets leads to inequitable charges for different DSP areas and is inconsistent with retail prices
- the inclusion of a headworks charge is sound but may be difficult to implement in practice
- we accept the exclusion of the Sydney Desalination Plant's assets from the headworks calculation as we agree the primary purpose of this infrastructure is drought response
- the proposed restriction to require MEERA valuation (rather than RAB or DORC) prioritises promotion of competition over efficient servicing solutions. This will create upwards pressure on customer bills.

3.4 The approach to the 'reduction amount'

We support IPART's decision as this is reasonable and consistent with retail price setting so allows equitable sharing of costs between developers and retail customers. We are however concerned with the removal of this component from current MSE charges as this may lead to sub-optimal outcomes while new connection charges for new development (developer charges) remain set to zero.

3.5 Differential application of discount rates

Our position in relation to discount rates relates to the proposed treatment of the capital cost component. While we agree that use of the utility's pre-tax WACC is an improvement from the current methodology, we believe this rate could have been applied to all components of the charge, if IPART allowed a consistent method for asset valuation and cost allocation. In summary:

- use of three discount rates is unnecessary and may require Sydney Water to simultaneously implement two cost allocation methodologies which are inconsistent with each other (if developer charges are re-introduced)

- we accept the update to the discount rate for post-1996 assets but our strong preference would be that this single discount rate is used for all assets with a nexus to development
- we support the decision to not include a WACC adjustment provision in the methodology as this would have introduced significant complexity in administration of the charges with very little potential benefit

3.6 Use of equivalent tenement (ET) for cost allocation

We support IPART's decision to update the ET value with the consumption for an average residential dwelling referred to in the prevailing periodic price determination. This is sensible and practical given residential properties remain the most common property type and this is a long-standing practice in the water industry.

In order to improve clarity for developers, it would be preferable for IPART to provide further guidance as to how ETs relate to non-residential and multi-unit residential property types. Our preference is for ETs to be defined according to the demand placed on infrastructure by each property type relative to an average residential property. This would be consistent with allowing non-residential properties to be assessed on a flows basis, such is the case for recycled water developer charges.

3.7 Competition and opt-out agreements

We agree with IPART that their proposed methodology decisions do not disadvantage wholesale customers or other WICA licensees – however, we note that only positive, cost-reflective developer charges provide an appropriate price signal to inform decisions about private sector entry and competition in the provision of water and wastewater services to new developments. IPART's draft decisions to require the use of MEERA valuation for existing assets, and to exclude pre-1970 assets essentially prioritises the promotion of competition over the efficient provision of services to end-use customers.

We strongly support IPART's proposal to allow sophisticated developers to opt out of regulated DSP charges through bi-lateral agreements. This is in line with our proposal to IPART's issues paper and has the potential to enable delivery of additional infrastructure or innovative services which customers value.

4 Procedural requirements for new connections to new developments

The core procedural requirement for new connection charges is to prepare and exhibit a Development Servicing Plan (DSP). We strongly support IPART's intention to suspend this requirement while the NSW's Government's zero developer charges policy applies and to only make minor amendments to this requirement otherwise. This chapter provides a summary of our position on each of IPART's proposed procedural decisions.

4.1 Summary of IPART's draft decisions on procedural requirements

Sydney Water generally agrees with IPART and other stakeholders that the current procedural requirements are appropriate. IPART has proposed three significant amendments to the current requirements. Our position on these changes are that we:

- support increased flexibility for the DSP review period
- strongly support suspending the requirement to review DSPs while the NSW Government's zero developer charges policy for Sydney Water and Hunter Water applies, and
- strongly support a transition period to comply with the determination if the zero developer charges policy is removed.

IPART has also proposed to maintain, with minor amendments, the current procedural provisions. We support these minor amendments relating to:

- the format and content of DSPs
- advertising, publicly consulting and registering DSPs, and
- the dispute resolution process.

4.2 Development servicing plan (DSP) requirements

Sydney Water agrees the following proposed changes are sensible improvements and will not add to the administrative burden:

- specify which system or systems (water supply, sewerage or drainage) the DSP relates to
- provide a comparison of the maximum price for connecting a new development to a system with the maximum price which applied previously.

4.3 DSP consultation requirements and dispute resolution process

IPART's proposed DSP consultation requirements and dispute resolution process are largely sound. We support IPART making no change to the existing dispute resolution process. Sydney

Water position in relation to IPART's proposed minor updates and changes to the consultation requirements are that:

- the new requirement that agencies make available on their website **all** background including the models used to calculate the charge may add administrative burden and be unworkable in practice. We note that it would not be appropriate for agencies to make any commercially sensitive information public nor is there value in making information of a highly technical nature available to the public. Our preference would be that IPART retain the requirement that more detailed information be made available 'on request' as this allows the opportunity to ensure the information provided makes sense to the person(s) who request it.
- we appreciate IPART's proposed changes to modernise update the requirements by removing references to repealed legislation and allowing utilities to take advantage of providing and receiving information via the internet.
- we note the Draft Determination uses some wording which may cause confusion and/or inadvertently give rise to disputes.

4.4 Improved DSP review requirements

IPART has made sensible improvements to the review requirements for DSPs. Sydney Water strongly supports IPART's draft decisions to:

- allow for the requirement to review a DSP once every five years to be shortened, extended or waived, as approved or directed by IPART. This will allow timely changes to be introduced should there be any significant deviation, within a five-year period, from the assumptions used to create a DSP. It would also allow for longer periods between reviews if those assumptions remain valid at the end of a five-year period.
- suspend the DSP review requirement while the NSW Treasurer's direction on zero developer charges is in place. We agree this is a practical measure which will save unnecessary administrative costs.

4.5 Transition in the event that the Government's nil developer charges policy is removed

IPART has allowed for up to 18 months for agencies to produce new DSPs should the NSW Government reverse its nil developer charges policy. This allowance is important and reasonable given the significant administrative effort would be required to complete this exercise.

Sydney Water's position is however, that the determination should be again reviewed prior to any reintroduction of the charges.

4.6 IPART role in regulating charge calculation and DSP boundaries

We support IPART continuing a light-handed approach to regulating the implementation of their determination. The developers who are directly impacted by the charges are best placed to provide feedback and/or challenge the charges if necessary. We appreciate IPART's support in providing a template spreadsheet for use on a voluntary basis. This may provide comfort to developers of consistency in approach between DSP areas and across jurisdictions.

We also support IPART maintaining their current approach to not prescribe how to set DSP areas. We agree that utilities are best placed to balance any trade-off between adopting smaller DSP areas for increased cost-reflectivity and larger areas to reduce both volatility in the charges and administrative costs. We also agree with IPART's suggestion that it is likely that there will be some consolidation of DSP areas should the nil charge policy be reversed. As outlined in our December 2017 response, we do not believe the large number of different DSP areas developed previously was efficient and also lead to unreasonable volatility in the charges in certain cases.

However, the inclusion of MSE projects in the scope of DSP areas raises a concern about the scope and content of DSPs. For example, if a DSP is intended to capture all larger scale MSE projects that use common assets, this will require significant pre-planning, including the development of servicing strategies. This could be a material cost to Sydney Water, with no clear avenue for cost recovery. For example, it would likely be impractical to charge MSE projects a share of planning costs, as applications are only likely to occur several years after the costs were incurred.

4.7 . Consistent CPI indexation of prices is preferable

We agree with IPART, Central Coast Water and Hunter Water that consistency of CPI indexation between our determinations would be beneficial. This move is sensible in that it may avoid any potential confusion and/or possibility of error from applying a wrong CPI index from a different determination.

4.8 Clarification needed around template spreadsheet assumptions and determination wording

We believe there are inconsistencies between the wording used in the Draft Report and Draft Determination and the assumptions used in the template spreadsheet. There are also a number of places where the wording used in the Draft Determination is unclear, and could lead to significant confusion among customers. These relate to:

- the intended start and end dates for calculation of the Equivalent Tenements (that is, to calculate L_1 , L_2 , L_3 , L_4 and L_5 in the Draft Determination)
- whether utilisation of assets should be based on total utilisation at the point in time the asset reaches capacity or the present value of the Equivalent Tenements which will use the asset over a set period

- whether ET should be proportional to the demand of an average residential dwelling or an average **single** residential dwelling
- the start date for calculation of the Operating Revenues (R_i), whether this should be 1 July or from the exact date the DSP is registered with IPART
- whether rounding should occur to the nearest cent. Past practice has been to round to the nearest dollar. Rounding to the nearest cent would be of little value to customers and leads to time consuming processes to enable refunds or adjustments if customers accidentally over or under paid by a matter of less than one dollar.

5 New connections to existing properties – prices to extend services

In this chapter, we discuss the implications for IPART's draft decisions given our extensive and ongoing experience with backlog sewerage and minor service extension schemes. We support IPART's intention to apply a consistent method to calculate the charges for any new property who wishes to connect. We however note, this is a significant change to the existing regime. Backlog sewerage (including properties identified under the NSW Government's Priority Sewerage Program - PSP) and minor service extension (MSE) schemes tend to be costly and at times contentious. We anticipate IPART's draft decisions may exacerbate this situation.

Sydney Water's position with respect to IPART's draft decisions are:

- We support use of a consistent method to calculate the charges for any new property who wishes to connect so long as the costs are shared in an equitable, transparent and administratively efficient manner. Although IPART's net present value (NPV) methodology could be improved (see Chapter 3), it is preferable that a single method be used for all properties. Our preference would be that IPART further refine their method at a subsequent review, preferably before any reintroduction of developer charges.
- We agree that while the costs of a new connection are the same, how they are shared between the connecting customers and the broader customer base, depends on the externalities arising from these connections. We welcome IPART's commitment to assess these departures from the standard charges on a case-by-case basis however note that this may not provide the certainty that potential MSE and PSP customers are looking for.
- We appreciate that IPART's approach would require utilities to charge on a marginal (rather than full incremental) cost basis for extending a service while the zero developer charges policy applies. This approach will still result in a step increase of around \$6,000 for water and \$7,500 for wastewater MSE charges for a residential property. If the nil developer charges policy is reversed, these charges may as much as double compared to the current methodology. IPART's decision to allow payment over 20 years will go some way to make the increase in these charges more affordable for affected properties.

5.1 Cost-reflective charges with consideration of wider beneficiaries and customer ability to pay

The level of customer contribution and caps provided in the current determinations for both PSP and MSE properties are not adequate for funding these services without additional contribution from our wider customer base. Sydney Water acknowledges that this kind of cross-subsidy is acceptable when provision of such services also provides additional value to the wider community. For example, pollution from on-site systems used by these properties, may be causing degradation to waterways which provide amenity to a much wider spectrum of the community than the connecting properties. Similarly, there may be a case to apportion some of the cost to wider

beneficiaries when more stringent environmental standards for growth occurs in catchments which discharge to sensitive receiving waters. Sydney Water supports the assessment of wider benefits being conducted on a case by case basis.

We agree that existing customers should be indifferent about whether capacity is provided to a new development or is used to extend a service to an existing property. That is, in both cases, when a new service is connected to a new or to an existing property, it is the bills paid by all other existing customers which have funded the spare capacity in the assets which enable those connections. Newly connecting customers should also compensate existing customers for any additional capital or operating costs arising from their connection. The incremental cost approach to capital costs should apply in all cases.

A customer's ability to pay

We recognise however that the incremental cost of connection can be significant in some cases. It is also likely to be much more difficult for an existing property owner than a developer to cover such costs. This is because it is more likely that these additional costs need only be borne for a short time by a developer until they can be recovered when they sell the property. Whereas, the owner of an existing property may need to bear these costs for many years because they only stand to be compensated via the uplift in their property value if and when they ever sell the property in the future. Sydney Water supports IPART's proposed ability to spread payments over 20 years for existing property owners.

Clarity needed for proposed grandfathering of MSE and PSP charges

We note that IPART's draft decision to grandfather existing MSE and PSP charges applied on an annuity basis is sensible given it is administratively simpler and provides equity for the cost of connection between neighbouring properties connecting to the same extension or scheme. However, we believe there may be an oversight in the wording used, as this would exclude many current MSE cases and PSP schemes. For example, current MSE applications that have not been finalised and existing MSE cases where a quote has been provided but a customer has not yet connected would appear to be excluded from the proposed grandfathering arrangement. We do not believe it fair that prices for MSEs should be subject to significant change once a customer has paid the application fee.

Sydney Water has a number of MSE cases in progress and we believe these cases should also be grandfathered. We recommend IPART revise the current wording in their Draft Report and Draft Determination to indicate that all cases where properties have applied for an MSE before the new determination becomes active would also be grandfathered under the previous methodology.

When planning for the delivery of services, Sydney Water considers the availability of infrastructure in adjacent areas. To deliver schemes at the lowest lifecycle cost, and depending on the expected timing of development in the wider region, there can be benefits in deferring the delivery of services. This has been the case in locations such as Austral, Menangle and Menangle Park, where early planning work identified the likelihood of large scale urban development nearby. For

these areas, residents have been informed that services will be provided once there is sufficient evidence of growth in surrounding land, a position that Sydney Water has held consistently since 2006.

Unfortunately, and for reasons beyond Sydney Water's control, there have been significant delays in the rezoning of adjacent land. In the case of Menangle, for example, land for urban development was released in 2001 but rezoning was only finalised in 2017. As a result, properties that formed part of the original PSP remain unserved. If applied to these areas, the draft determination could significantly alter the funding contribution required by residents and may undermine the financial viability of the schemes. At the same time, however, the increase in the surrounding population could potentially increase risks to public health and the environment if the PSP areas remained unserved. These issues should be carefully considered by IPART in finalising this review.

5.2 Making Community Service Obligation (CSO) funding by NSW Government contestable

Since the introduction of WICA in 2008, water and sewerage services can now be provided by any entity with a WIC Act Licence. It therefore makes sense to make any CSOs relating to water and sewerage services contestable. Sydney Water supports competition where it delivers innovation and value for customers. We agree with IPART that CSOs should be clearly defined and funded and available to all suppliers in the market.

5.3 Reporting burden for small-scale schemes

We appreciate IPART's draft decision to make procedural requirements proportionate to the size of the scheme but are concerned this may result in our commercial decisions being challenged unnecessarily and unreasonably. IPART's proposed requirement will extend the time required to process applications. We do not believe that the requirement to produce such small-scale DSPs is in line with IPART's decision to allow utilities to determine the boundaries for any DSP they produce.

Our strong preference would be for IPART to remove this requirement for MSE and PSP cases. If they do include this requirement in their final determination we note the Draft uses the terms, *small scale* and *large-scale (township level)*. As neither of these terms are defined, customers may expect us to produce a full DSP in cases where we feel it is not warranted. In addition, we would appreciate IPART providing assurance that we will not be penalised where we have chosen to classify an MSE as 'small-scale' rather than large scale. Preparation of a DSP may also create an expectation that Sydney Water has committed to building the infrastructure, when in reality a decision to proceed will be contingent on a sufficient number of customers voluntarily deciding to connect.

If IPART retains DSP requirements for MSE and PSP areas in their final determination, we recommend IPART define the terms *Small scale* and *Large-scale (township level)*. That is, provide definitions of these in terms of number of ETs served or total average day demand.

5.4 Planning required to provide a quotation for an MSE

Currently, Sydney Water only conducts planning of MSE cases after we receive payment of the MSE application fee set by IPART⁶. In practice, we have found that this fee is far below the actual cost of conducting such planning. The current fee is set to the same level as an application for a Section 73 Compliance Certificate. However, the section 73 process is fundamentally different to the process for a minor service extension request:

- For section 73 applications, Sydney Water considers the location of the property, the likely demand on our networks, and provides advice on the availability of points of connection to those networks. Based on this information, the applicant is responsible for the design and construction of new assets. For larger developments, the applicant may also need to develop a servicing strategy (if one currently doesn't exist).
- For minor service extension applications, Sydney Water will also prepare a design because we typically undertake construction. The different emphasis in the MSE process is reflected in the new procedural requirements outlined in the draft determination, which includes a need to prepare a formal DSP for larger schemes.

It is important that application fees signal to property owners the cost and value of the planning required to provide a quotation. IPART's Draft Determination and Report are silent on what process should occur before Sydney Water conducts planning for an MSE. IPART may also wish to consider including all MSE related charging in their Final Determination of these charges. If this occurs, we suggest a two-step application process would be preferable. That is, an initial application fee could be set which covers the cost to provide an indicative quote or likely order of cost estimate. If a property owner or owners felt that this quotation represented good value, they could then proceed to paying a full application fee which would more closely align with the actual cost to prepare such a quote. We would be happy to provide IPART with more detailed information to help them determine such charges.

We note that our position here is the same as for the related issue for upgrades for an existing service to existing properties, described in Section 6.3)

⁶ IPART sets this fee in our retail price determination. *IPART Determination No. 5, 2016, Sydney Water Corporation, Maximum prices for water, sewerage, stormwater, drainage and other services from 1 July 2016*

6 Prices for upgrading existing services for firefighting

This chapter outlines our views on IPART's draft decision to set a methodology for a new charge for upgrading existing services to existing properties. These existing service upgrades (ESUs) have the potential to enable cost-effective provision of water flow and pressure for firefighting. We strongly support this aim and have been working collaboratively with Fire and Rescue NSW (FRNSW) and local Councils to address this issue over the last few years. As IPART has previously noted, there remain gaps in the regulatory regime on water flow and pressure for firefighting in NSW. This means IPART's draft decision is unlikely to result in cost effective solutions being implemented in the majority of cases.

6.1 Firefighting capacity is not being delivered efficiently for existing properties and infill development

Over the last few years, we have become aware of firefighting capacity problems for some existing properties. This issue predominantly relates to low rise apartment buildings where firefighting capacity does not meet the current standard under the Building Code of Australia (BCA). There are streets where a group of buildings may all need to upgrade their on-site firefighting capacity to meet the current requirements. It is very likely that the total cost to provide additional on-site capacity for each of these properties is higher in total than it would be to upgrade the water main in the street. Currently there is no framework to support such a solution.

Sydney Water is keen to work with stakeholders to address this issue.

6.2 A funding framework is only part of the solution

As IPART reiterated in their Draft Report, there is a need to examine all regulatory gaps or necessary improvements to regulatory arrangements for firefighting water capacity requirements within NSW. IPART's draft decision to provide a methodology for a voluntary charge for an upgraded service to existing properties will only address part of the problem. That is, once the determination of this ESU charge becomes active, there would be a clear method for utilities to follow to calculate these voluntary charges. However, what remains missing, is the framework which would make such voluntary requests likely and hence the calculation of such charges result in reasonable, equitable and financially viable funding of these upgrades.

Currently, where upgrading the water main provides a lower cost solution to fire service upgrades to all buildings, there is:

- no requirement to implement a least cost solution
- no means for Sydney Water to recover costs from all buildings benefiting from the water main upgrade.

There is no agency clearly directed to lead the planning of these solutions. Such a plan would require roles and responsibilities agreed by a number of stakeholders and should be led by an

appropriately placed government body who could be held accountable for delivery of the plan. At a minimum, we believe the following agencies would be required to contribute to this planning:

- the local water utility or utilities
- FRNSW
- Local Government Council(s)

The decision to progress this issue further is a matter for government. However, Sydney Water is happy to contribute to any future initiatives to find efficient, equitable and financially viable firefighting capacity solutions for the customers we serve.

6.3 Implementation issues for the new ESU charge

Given the lack of a suitable regulatory framework in which to levy the new charge, we see a number of implementation issues our business will need to address.

Financially viable delivery of services

Sydney Water's Operating Licence states we must ensure that the services we deliver are safe, reliable and financially viable. We take our responsibility to ensure services are financially viable seriously as we do not wish to waste our customer's and/or the NSW Government's money. As such, Sydney Water will need to develop a policy for implementation of the new charge to upgrade a service with our Operating Licence requirement in mind.

Sydney Water already has a policy for implementation of MSE charges. Although the new upgrade charges are similar to MSE charges, as noted in the previous sections, ESU charges are subject to even greater uncertainty as to which customers should contribute and the likely timing of those contributions. The ESU charges resulting from IPART's methodology will be highly sensitive to the forecast of when each contributing property makes their contribution. This is already a problem for MSE charges, where Sydney Water has no ability to force customers to connect to the MSE once it is built. As such, the forecast we adopt for MSE property connection may result in over or under-recovery of the actual cost. For ESUs, the uncertainty in such forecasts is extreme as:

- the number of potentially benefitting properties may range from less than ten, to many hundreds
- the larger the number of potentially benefitting properties, the greater the difficulty in determining which of these properties should pay and when they should be liable for such a charge
- there may only be a small proportion of existing properties who stand to gain immediate benefit. That is, only the properties who have recently had their fire-fighting capacity assessed as being inadequate. Other properties may still stand to benefit from the service upgrade in the future, particularly if their property becomes part of a future infill development application. However, the timing of such development is impossible to predict so will not be able to be factored in.

- Even if the timing of future infill development could be predicted, IPART's determination does not provide a mechanism to charge properties who will benefit from an upgrade in the future. That is, once an upgrade to the main which services a group of properties has been built, all properties connected to that main will automatically receive the upgraded service, whether they voluntarily requested and paid for it or not. In comparison to MSE properties, who can be charged at any time in the future if they chose to connect, we can see no way for any future ESU properties to be retrospectively charged for an upgrade if they did not volunteer to pay for it at the time it was built.

The above factors show the extreme uncertainty around not only if and when other properties may benefit in the future, but that there is essentially no guarantee of Sydney Water receiving additional funding for an upgrade after it has been built. In order for such upgrades to be financially viable, Sydney Water will be forced to assume that only properties who have currently volunteered to pay will fund the project. This means that the charges are likely to be much higher than that if all current and future benefitting properties could be taken into account.

It is unfortunate; however, we believe IPART's provision of a methodology for an upgraded service charge will be largely ineffective in achieving efficient, equitable and financially viable firefighting capacity solutions as it only addresses how upgrades could theoretically be funded, without providing a framework to ensure that such funding will occur in practice.

Planning required to provide a quotation for an ESU

Currently, Sydney Water only conducts planning of MSE cases after we receive payment of the MSE application fee set by IPART⁷. In practice, we have found that this fee is far below the actual cost of conducting such planning. However, it still provides a signal to property owners that such planning is a valuable service in itself. IPART's Draft Determination and Report are silent on what process should occur before Sydney Water conducts planning for a service upgrade. At a minimum, we believe an application to receive a quote for an ESU should attract the same fee as an application to receive a quote for an MSE.

IPART may also wish to consider including all MSE and ESU related charging in their Final Determination of these charges. If this occurs, we also suggest a two-step application process would be preferable for both charges. That is, an initial application fee could be set which covers the cost to provide an indicative quote or likely order of cost estimate. If a property owner or owners felt that this quotation represented good value, they could then proceed to paying a full application fee which would more closely align with the actual cost to prepare such a quote. We would be happy to provide IPART with more detailed information to help them determine such charges.

⁷ IPART sets this fee in our retail price determination.
IPART Determination No. 5, 2016, Sydney Water Corporation, Maximum prices for water, sewerage, stormwater, drainage and other services from 1 July 2016